

# **GREAT RECESSION AND U.S. CONSUMERS' BULIMIA: DEEP CAUSES AND POSSIBLE WAYS OUT\***

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## Abstract

This paper attempts to shed light on some aspects of the U.S. consumers' apparent bulimia that was at the origin of the recent global crisis. We seek to show how different characteristics of the American society and economy, which are usually considered separately, are consistently related to such a multifaceted phenomenon. Hence, we illustrate some structural features of the U.S. economy and public policies that may contribute to create a difference, in terms of patterns of consumption and participation in market activities, between the U.S. and some other advanced economies (in particular, the major economies of continental Europe). We then proceed by presenting some explanations of the U.S. hyper-consumerism. We do so by introducing concepts and analyses elaborated by psychologists and sociologists that may help relating this phenomenon to the decline in subjective well-being and social capital documented in the U.S. over the period preceding the crisis. Moreover, we discuss how the NEG (Negative Endogenous Growth) paradigm can account for the recent U.S. consumption boom by treating it as part of the typical reinforcing loop that characterizes the U.S. pattern of economic growth. Finally, we focus on how the U.S. can exit from the current crisis: we underline some weaknesses of the two politically more realistic policy alternatives, and we outline a third exit strategy, which would possibly be preferable in terms of people's long-term well-being.

*Keywords:* hyper-consumerism; working time; negative externalities; happiness; growth rebalancing.

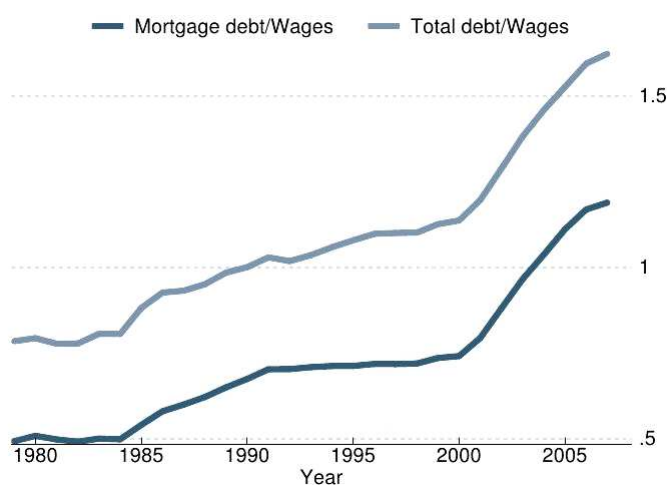
*JEL classification codes:* D10; D60; E20; F40; I31; J22; O11; O16.

# 1 INTRODUCTION

At the origin of the global financial crisis that began in the Summer of 2007 there was the accumulation of an unsustainable level of debt by the U.S. households<sup>1</sup>. A large fraction of this debt was contracted to finance the consumption boom that was the main driver of U.S. economic growth in the period preceding the crisis. This is even more true if one considers that the purchases of new houses, which played an important role in that growth episode, are nothing more than purchases of consumer durables, although they are recorded in national accountings as investment expenditures<sup>2</sup>.

No doubt that the consumption boom that led to the crisis was made possible by financial innovations, deregulation of financial markets and scant supervision, which combined with the peculiar macroeconomic policies conducted both in the United States and in some emerging economies, allowed the U.S. consumers to have unprecedentedly easy and cheap access to credit (see Figure 1).

Figure 1: Average US Household Residential Leverage\*



\*Average US household residential leverage computed as household debt divided by wage  
Source: Jagannathan et al. (2009)

However, that boom was not an isolated episode, but part of a trend of steady increase in

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<sup>1</sup>Saving, on the contrary, fell constantly until the crisis erupted and started denting accumulated wealth. In the period 2003-2007, US household saving fell to a meager 2.5% of disposable income, the lowest level since the early 1990s.

<sup>2</sup>Residential fixed investment peaked at 6.3 percent of GDP in the fourth quarter of 2005 and then fell to a record low of 2.4 percent in the second quarter of 2009, to stay at 2.5% both in 2010 and 2011.

the U.S. consumption rate that had started in the 1980s (Lee et al., 2010).

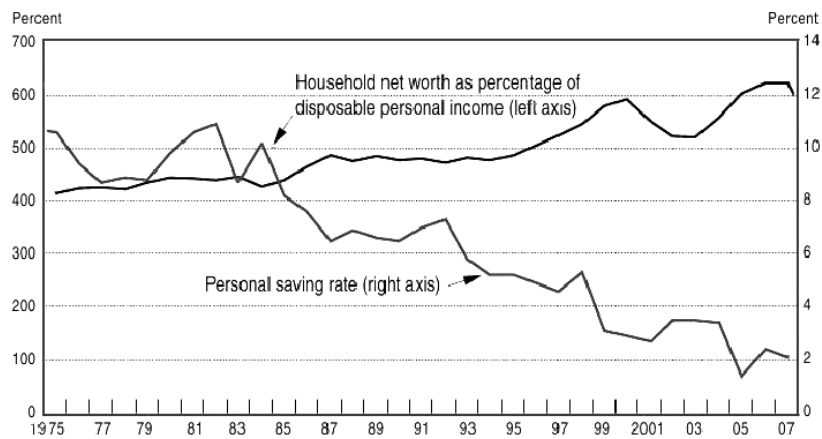
American households financed this excess consumption by going deeply into debt. It is natural, therefore, to call for convincing explanations of why the U.S. households, after having already experienced a long period of rising consumption, were still eager to buy more consumer goods and services, rather than, for instance, reducing their market work and dedicating more time to their families and friends. The need for such explanations is evident if one takes into account that, relative to their counterparts living in other advanced countries, U.S. households do not appear to have used a considerable portion of the productivity improvements that took place in the last decades for reducing their market work; while at the same time there were signs of increasing dissatisfaction and distress among Americans that may be linked to the weakening of social ties and to the erosion of those sources of enjoyment that do not pass through the market.

In its attempt to shed light on some aspects of the U.S. consumers' apparent bulimia, this paper seeks to show how peculiar characteristics of the American society and economy, which are usually considered separately, are consistently related to such a multifaceted phenomenon. Hence, we proceed by illustrating in section 2 some stylized facts and structural features of the American economy, which – together with U.S. public policies – may have contributed to create a difference, in terms of patterns of consumption and participation in market activities, between the U.S. and some other advanced economies (in particular, the major economies of continental Europe).

Section 3 presents some explanations of the U.S. hyper-consumerism. It does so by introducing concepts and analyses elaborated by psychologists and sociologists that may help relating this phenomenon to the decline in subjective well-being and social capital documented in the U.S. over the period preceding the crisis. Finally, section 3 discusses how the NEG (Negative Endogenous Growth) paradigm can account for the recent U.S. consumption boom by treating it as part of the typical reinforcing loop that characterizes the U.S. pattern of economic growth.

Section 4 focuses on how the U.S. can exit from the current crisis: it underlines some weaknesses of the two politically more realistic policy alternatives, and it outlines a third exit strategy, which would possibly be preferable in terms of people's long-term well-being. Section 5 briefly concludes.

Figure 2: U.S. Personal Saving Rate and Household Net Worth\*



\*Personal saving rate and household net worth as percentage of disposable personal income

Source: McCully (2011)

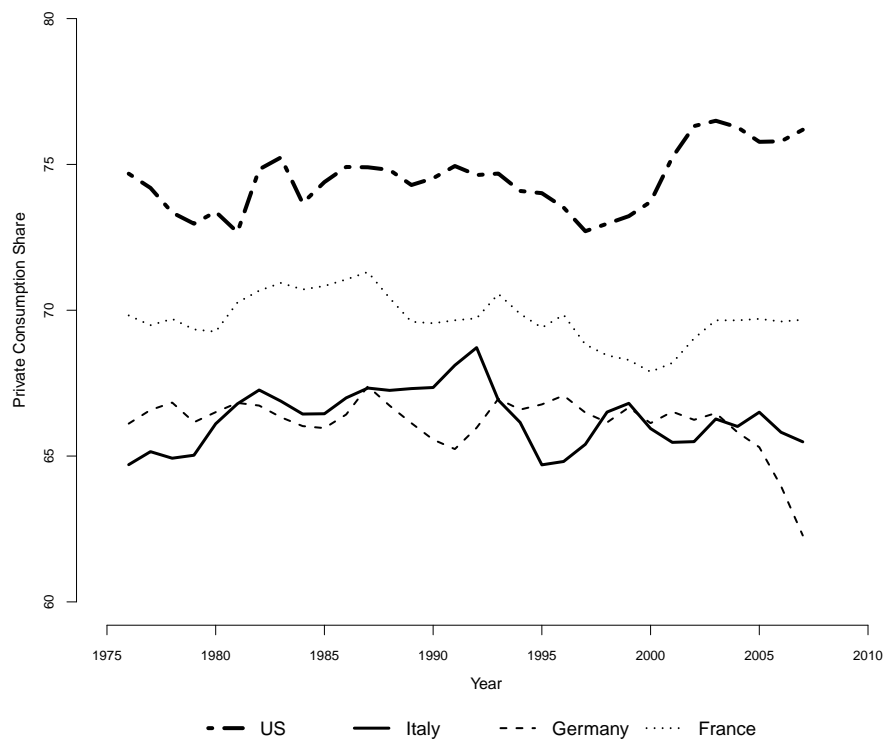
## 2 SOME STYLIZED FACTS AND STRUCTURAL PECULIARITIES OF THE U.S. ECONOMY

### 2.1 Consumption

Not only did the United States initiate in the 80s a long period of increasing consumption (see Figure 2), but its private consumption-to-GDP ratio has remained persistently and substantially higher than in the major countries of continental Europe (see Figure 3).

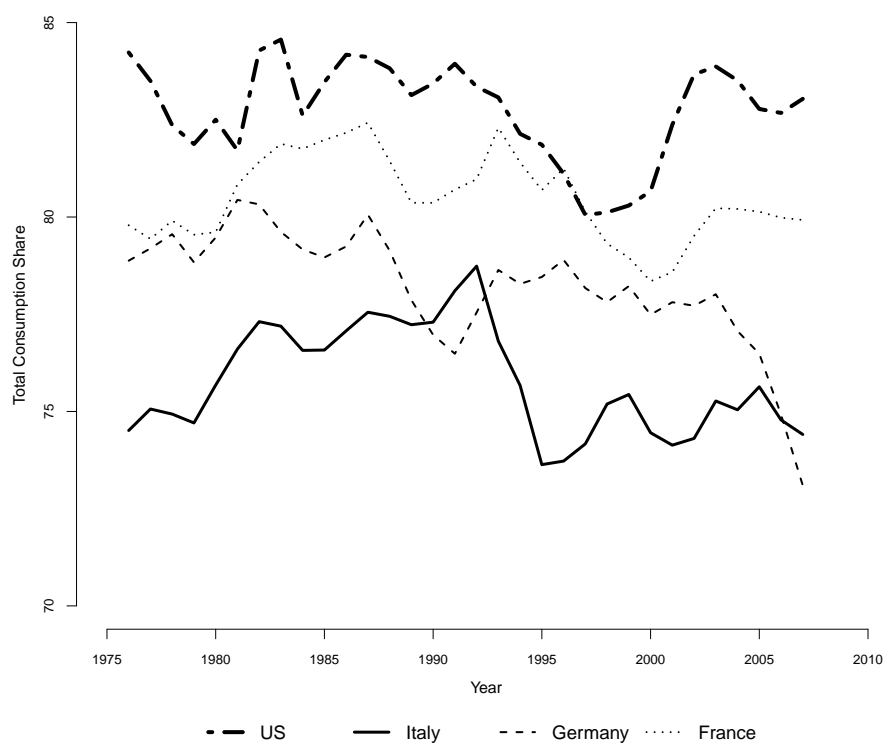
In part, this is certainly due to the fact that in the U.S. public consumption has typically been a smaller fraction of GDP than in continental Europe, but even adding private and public consumption together, it remains that U.S. total (private plus public) consumption has represented a considerably larger share of GDP than that of continental Europe (see Figure 4)

Figure 3: Private Consumption-to-GDP Ratio Across Countries\*



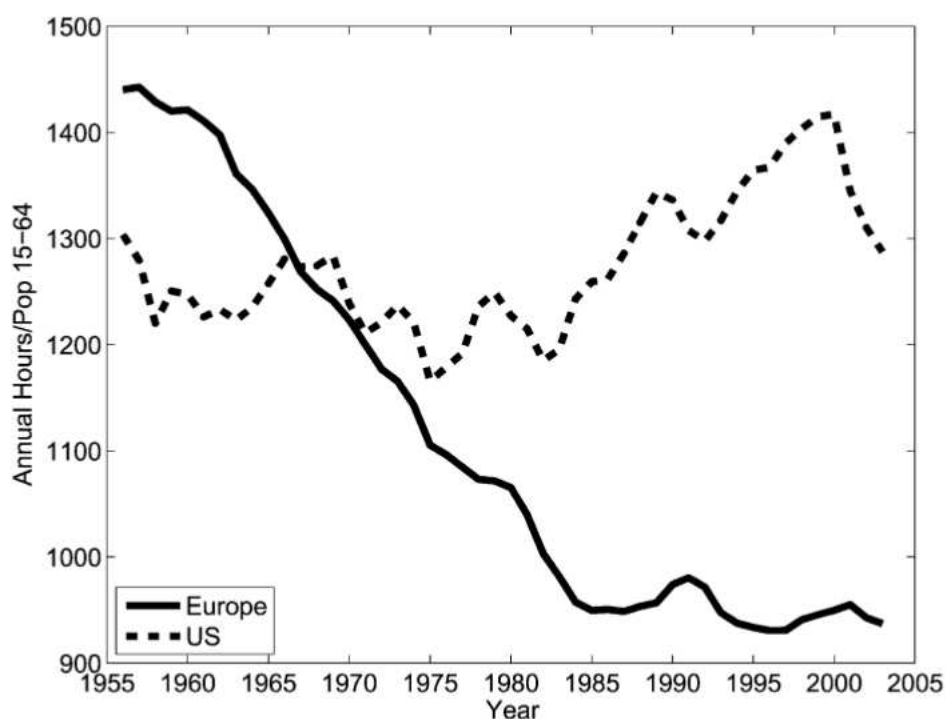
\*Our consumption measure is expressed in PPP GDP per capita (2005 constant prices)  
Source: Heston et al. (2011)

Figure 4: Total Consumption-to-GDP Ratio Across Countries\*



\*Our consumption measure is the sum of private and government consumption expressed in PPP GDP per capita (2005 constant prices)  
Source: Heston et al. (2011)

Figure 5: Aggregate Hours in the United States and Europe\*



\*Figures about Europe include Italy, Germany, France, Belgium and the Netherlands  
Source: Rogerson (2008)

## 2.2 Working time

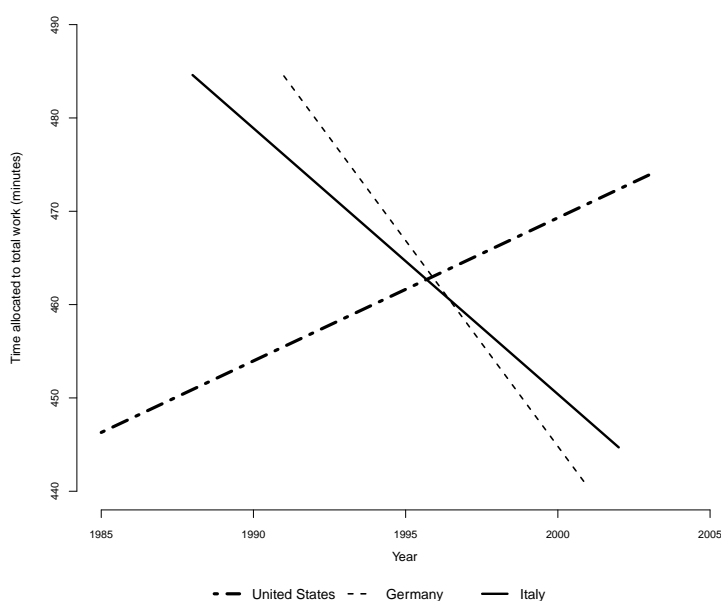
The trend of steady increase in the U.S. consumption rate was significantly paralleled by the increase in per capita hours of market work that occurred in the U.S. over the period 1970-2004, while in the same period the countries of the euro area displayed a remarkable fall in per capita hours of market work (see Figure 5 and Figure 6).

The higher consumption propensity of the United States relative to continental Europe should be related to the larger fraction of their time that the U.S. households have devoted to market work in comparison with their European counterparts, which have partially compensated the shorter time spent on paid work by working more hours at home than those worked by Americans (see Figure 7). Indeed, the available evidence shows that Europeans have enjoyed more leisure than the Americans and have self-produced part of those services that the Americans have bought on the market (Davis and Henrekson, 2004, Olovsson, 2009, Freeman and Schettkat, 2005, Burda et al., 2007, Aguiar and Hurst, 2007, Rogerson, 2008).

With regard to this, Rogerson (2008) emphasizes that the decline in hours of market work,



Figure 6: Trends in Total Work Across Countries\*



\*Average minutes per day for person aged 20 - 74  
 Source: Burda et al. (2007)

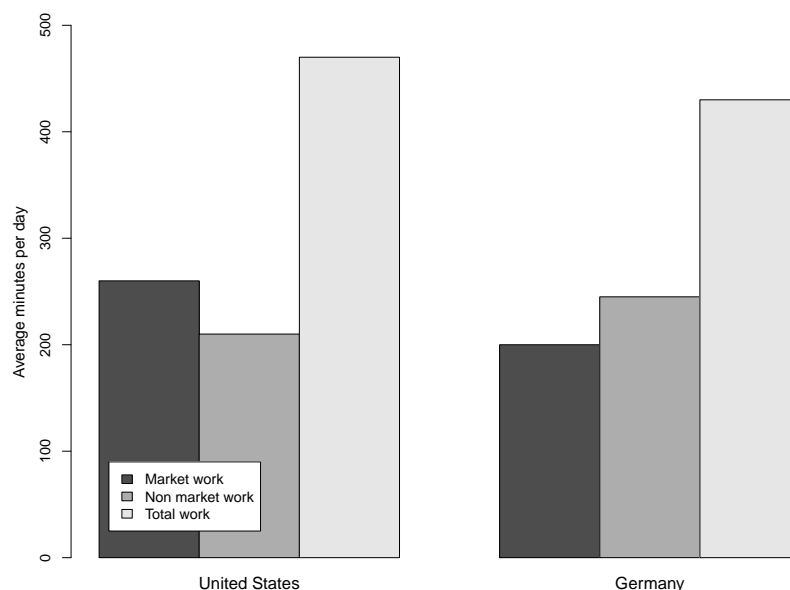
which continental Europe experienced compared to the U.S. in the years 1956-2003, is almost entirely accounted for by the fact that in continental Europe the trade and service sectors represented a substantially smaller share of work hours and GDP than in the U.S.

### 2.3 Taxes, welfare systems, unions and regulations

The parable of German mothers cooking more at home, while their American counterparts more frequently go out to eat at restaurants as they spend their higher income earned from devoting more time to paid work on higher market consumption (Gordon, 2006), points at the higher degree of “marketization” characterizing the American society relative to continental Europe (Freeman and Schettkat, 2005).

Public policies have given a major contribution to determine this difference. It was widely debated to what extent lower taxes on labor income and consumption in the U.S. can explain the larger fraction of their total time allocated to market work by American households relative to their European counterparts (see Prescott, 2004, Alesina et al., 2005, Gordon, 2006). It was also stressed that higher European taxes pay for more comprehensive and generous welfare systems, which have disincentive effects on work effort and labor market participation (Ljungqvist and Sargent, 2007). In particular, it has been argued that the provision of universal

Figure 7: Differences in Time Use Between United States and Germany\*



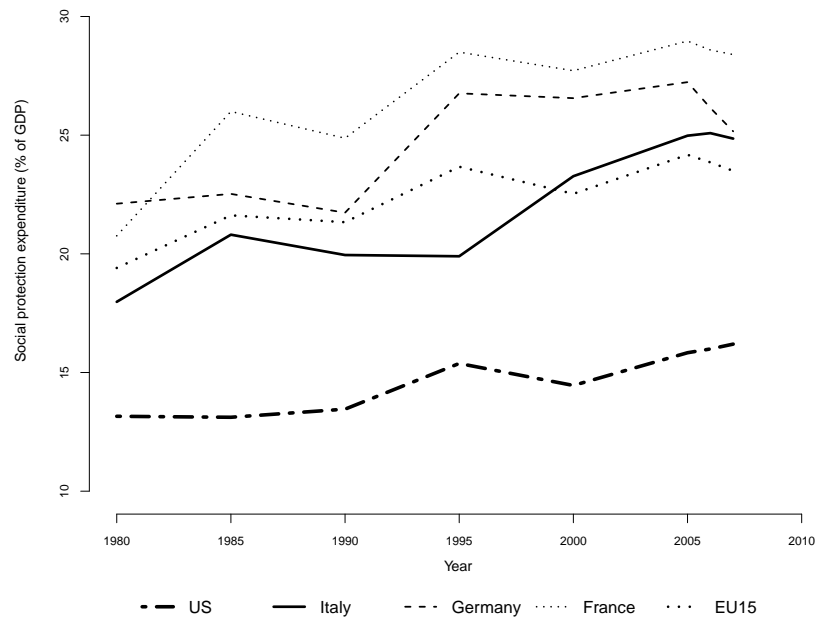
\*Average minutes per day for person aged 20 - 74. For United States: 2003; for Germany: 2001 - 02  
 Source: Bonatti (2008)

health insurance by the government, or the pervasive role played by a public funded education system, reduce considerably the pressure on Europeans to increase their labor income in order to buy essential services that Americans have to buy on the marketplace. In addition, it is probably the case that the declining real wages of the less educated (Autor et al., 2008) and the growing skewness of the American income distribution<sup>3</sup> contributed to induce a large portion of the U.S. households to augment their hours of paid work in order to not be left too behind. In general, one can conclude that the fact that public policies provide less social protection and are less redistributive in the United States than in Europe is likely to explain at least part of the difference between the two sides of the Atlantic in per capita hours of paid work amongst lower income households. In figure 8 can be seen the differences in the levels and trends of public expenditures on welfare and social protection between the U.S. and some European countries.

It is well known that the influence of unions in the determination of wages and other as-

<sup>3</sup>See, e.g., Dew-Becker and Gordon (2005): they document that the growth in median labor income which was 0.8 points per annum slower than the growth in the overall productivity over the period 1966-2001.

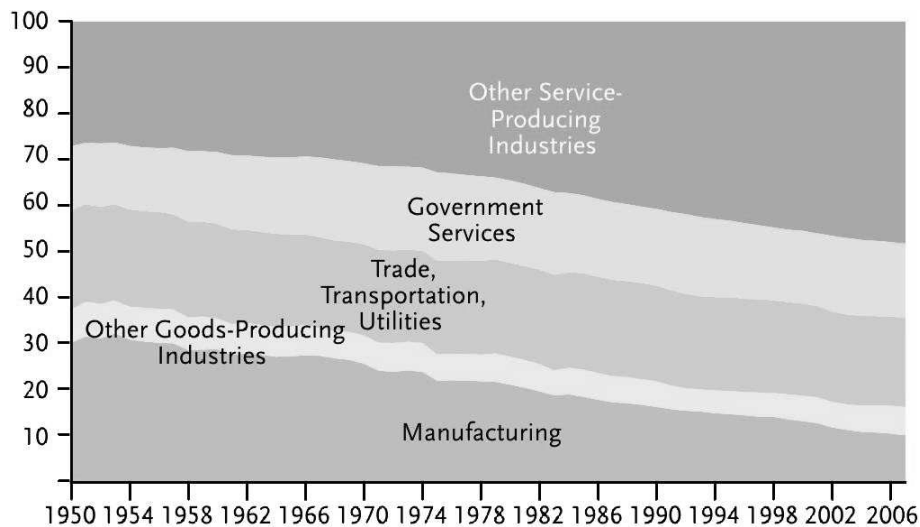
Figure 8: Trends of Aggregated Public Expenditures on Welfare and Social Protection\*



\*Trends of aggregated public expenditures on welfare and social protection as a percentage of GDP, for a selected sample of countries  
 Source: OECD (2012)

pects of employment relations has been declining in most advanced countries; nevertheless it has remained significant over the last forty years in most of Western Europe, while in the United States it has become quite marginal. This difference has to be linked to legislations that in Europe, differently than in U.S., give recognition and protection to unions. Moreover, in continental Europe, legislated rules on hiring, firing and working time tended, at least until the 1990s (after which in most countries they were quite substantially relaxed), to limit the employers' right to manage much more than in the U.S. Finally, in continental Europe regulations of product markets that create barriers to entry or limit price competition were typically much more pervasive and tighter than in the United States, although - again beginning with the 1990s - a loosening of these regulations is going on in most European countries. All these differences in the functioning of the labor and product markets have probably played a role in preserving a gap between continental Europe and the United States in the development of those sectors - especially trade and personal services - in which the creation of jobs is very dependent on the flexible and cheap utilization of manpower, and on households' marginal convenience to buy a service on the market rather than self-producing it, or rather than not buying it and enjoying

Figure 9: US Share of Nonfarm Employment by Major Industrial Sector (1950 - 2007)\*



\*Bureau of Labor Statistics, *Current Employment Statistics, 1950 to 2007 (March)*  
 Source: Lee and Mather (2008)

more leisure.

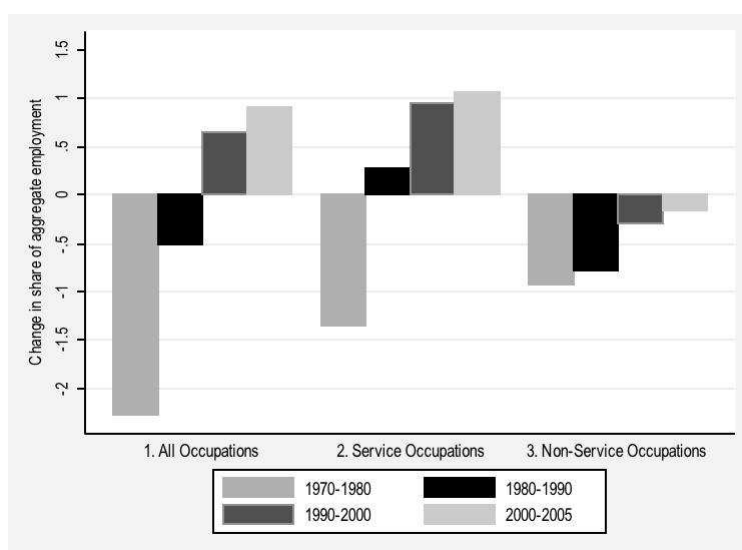
## 2.4 Macro framework

As a matter of fact, the sectors providing consumer services and residential housing are those that in the years have created the millions of jobs which give employment in the United States to most low-skilled and marginal workers (see figure 9 and 10)<sup>4</sup>.

The fact that the relative size of these sectors - which are typically those not exposed to foreign competition - has remained larger in the U.S. than in the other advanced economies must be also related to the very loose external constraint faced by the U.S. economy. The unique role of the dollar as international reserve currency, the unrivalled liquidity of U.S. bond markets, the safe-haven status associated to U.S. assets have facilitated the financing of the U.S. excess expenditures (Obstfeld, 2010), permitting the United States to have a volume and a rate of expansion of domestic demand persistently in excess of the resources generated within the country. More recently, in the 2000s, China's piling up foreign reserves mostly denominated in U.S. dollars has been important for allowing a smooth placement of U.S. increasing foreign

<sup>4</sup>The ratio of construction employment over total non farm employment has been basically increasing over past decades. For example, from 1996 to 2006 the share of employees in the construction sector over total non farm employment went from 4.54% to about 6% (Mullins, 2006). Moreover, the services sector in 2001 employed about 80% of the total US labor force. In the same year, the European share was about 70% of the total labor force (D'Agostino et al., 2006).

Figure 10: Change in US Share of Aggregate Employment\*



\*Share by decade 1970 through 2005 in occupations comprising the lowest skill quintile of employment in 1980  
 Source: Autor and Dorn (2009)

liabilities and keeping low U.S. long-term real interest rates (see Bonatti and Fracasso, 2010).

Emerging countries fed the U.S. consumers' bulimia, not only by helping to finance their expenditures, and thus contributing to inflate those sectors producing non-internationally tradable products that represent a major source of jobs for U.S. low-skilled workers, but also providing cheap manufactured goods (see figure 10). This has obviously crowded out the U.S. production of internationally tradable goods.

However, one could argue that a long-standing reduction of the U.S. trade deficit-to-GDP ratio would have required-together with some devaluation of the dollar vis-à-vis the currencies of major trading partners like China-U.S. macroeconomic policies consistent with a permanently slower expansion of domestic demand, with a depressive impact on the growth of the sectors producing only for the domestic market. Given the more labor-intensive nature of these sectors relative to those producing tradables, it is likely that the net effect on total employment of such policy switch would have been negative.

## 2.5 Systemic puzzles and financial deregulation

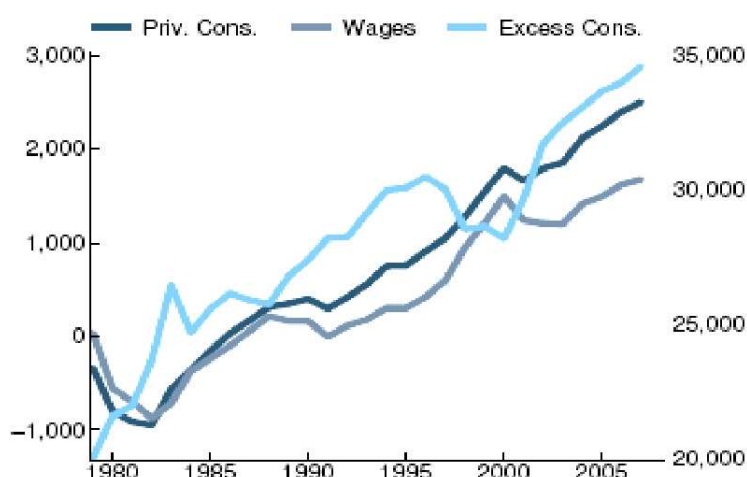
The point just made helps grasp the dilemma faced by U.S. policy makers. Taken for granted the very large share of consumption on U.S. GDP and the sectoral composition of the U.S. economy, any shock or policy change reducing the consumption propensity tends to have, at

least in the short run, remarkable negative effects on economic growth and employment. This is considered socially and politically unacceptable in the United States, where keeping low the unemployment rate has a higher priority amongst the public than in European countries, since the latter have welfare systems that give – as we have noticed – more generous and universal protection to those in need. Furthermore, most other advanced countries, having relatively larger tradable sectors and more stringent external constraints than the U.S., are more inclined than the latter to pursue policies aimed at improving the international competitiveness of their products and have weaker incentives to boost domestic consumption. In contrast, it is likely that in no other country except the U.S. a high consumption propensity is perceived to be so important for social stability because of its implications in terms of overall economic activity and employment. The fact that, because of the structural characteristics of the U.S. economy, even modest shifts in the consumption rate tend to have serious effects on key economic and social indicators creates a sort of path dependency, in the sense that politicians are extremely reluctant to deviate from policies supporting high consumer spending, even if they are hardly sustainable in the long run. It was probably not only for the symbolic significance attached to consumption, but also for its more concrete function of being the main driver of U.S. economic growth and employment, that in the aftermath of September 11<sup>th</sup> George W. Bush is alleged to have evoked a “patriotic duty to consume”.

At this point, a puzzling question comes naturally: how to keep high consumption growth if the real wages of a large fraction of the population are stagnant or grow less than GDP? At the end of the 1990s, indeed, the possibility for the U.S. households to increase their hours of paid work had practically reached a limit. A provisory solution to this systemic puzzle was given by the process, started in the 1990s and fed both by legislators’ decisions and regulators’ lax attitudes, that led to the relaxation of lending standards and to the possibility for under-qualified borrowers to qualify for loans and mortgages. Indeed, firms could reconcile their need of low wages to compress costs and raise profitability with their need of high consumer demand to increase sales and boost profits thanks to the possibility for low- and medium-income households to go massively into debt, so as to finance their purchases of consumer goods or houses (see Figure 11).

The real estate bubble of the 2000s was fueled by the mortgage industry’s aggressive practices for enlarging its business, and in its turn this made possible to households to withdraw

Figure 11: U.S. Private Consumption and Total Wages\*



\*Private consumption and total wages, including benefits (right axis) along with excess consumption calculated as private consumption less total wages (left axis). All numbers are in 1980 \$ per household

Source: Jagannathan et al. (2009)

equity from their houses as their prices rose so as to finance further consumer spending (see Figure 12).

Consumer credit and mortgages are finalized for the purchase of goods and properties, and it is hard to think that people could get them in order to finance a period out of work and spend more time with relatives and friends or a temporary reduction of working time. It is not surprising, therefore, that the households' easier access to credit translated into an exacerbation of the ongoing trend toward more consumption.

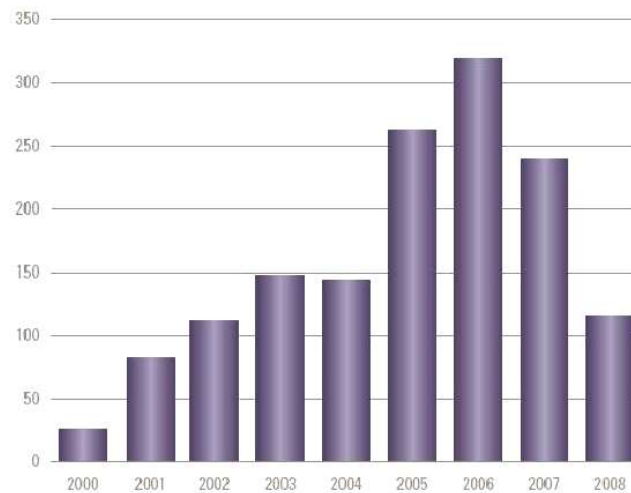
## 2.6 Happiness, social capital and materialism

It may appear surprising that, in years of rapidly increasing per capita consumption, self-reported well-being (SWB) declined in the United States (see Figure 13).<sup>5</sup>

The diminishing American self-reported happiness is paralleled by a long-standing increasing trend in the number of people reporting depression, anxiety and neuroticism (Twenge,

<sup>5</sup>The reliability of SWB measures has been corroborated by experimental evidence from several disciplines. For example, SWB correlates with objective measures of well-being such as the heart rate, blood pressure, duration of Duchenne smiles and neurological tests of brain activity (Blanchflower and Oswald, 2008, van Reekum et al., 2007). Moreover, SWB measures are correlated with other proxies of SWB (Schwarz and Strack, 2003, Wanous and Hudy, 2001, Schimmack et al., 2010) and – more interestingly – they mirror the judgements about the respondent's happiness provided by acquaintances or clinical experts (Schneider and Schimmack, 2009, Kahneman and Krueger, 2006, Layard, 2005).

Figure 12: Equity cashed out at refinancing in the U.S.\*



\*Equity cashed out at refinancing expressed in billions of 2008 US dollars. All values are adjusted for inflation by the CPI-U for All items  
Source: FreddieMac (2011)

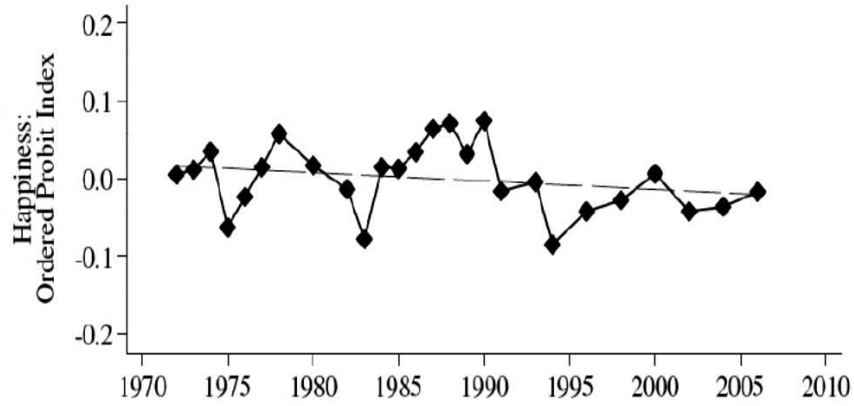
2000, Wilkinson and Pickett, 2009, Diener and Seligman, 2004). In sum, all available measures of well-being, both subjective and objective, point to a decrease in well-being in the U.S. over the last decades. This trend seems to be different from the European one, which exhibits a rise in self-reported well-being (see Figure 14).

The decline in happiness was accompanied in the U.S. by what Putnam (2000) documented as a gradual erosion of interpersonal trust, social connectedness and other variables related to social capital. Putnam's findings were disputed (Ladd, 1996) and underwent strong scrutiny, but finally they appear to have been substantially confirmed: Paxton (1999), Robinson and Jackson (2001), Costa and Kahn (2003) and Bartolini et al. (2011), using a variety of indicators and different data-bases provided some convincing evidence of the long-term erosion of US social capital (see Appendix A). It is worth emphasizing that the decline in social capital is another specific feature of the U.S., since some evidence concerning interpersonal relations and trust in institutions seems to show that Europe does not exhibit any sign of decline in social capital (Sarracino, 2011).

The capacity of a population to build and preserve social capital appears to be affected by the diffusion of materialistic values. Positive psychologists define materialism as a system of personal values ascribing great importance in life to goals such as money, luxury consumer's goods and success, while attributing a lower priority to affection, human relationships, soli-

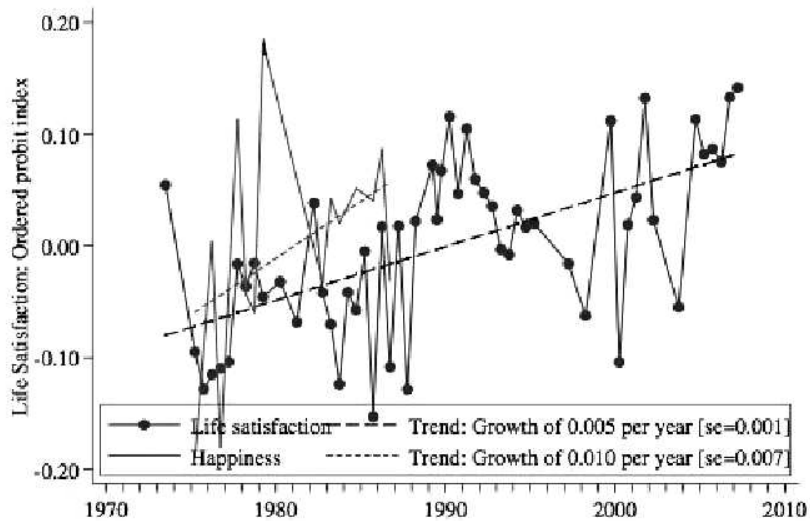


Figure 13: Trend of U.S. Happiness\*



\*Trend of average happiness over time. Happiness is an ordered variable ranging from 1 (not too happy) to 3 (very happy)  
 Source: Stevenson and Wolfers (2008)

Figure 14: Trends of Happiness and Life Satisfaction in Europe\*



\*Trend in European well-being as proxied by happiness and life satisfaction. The picture shows both the average yearly trends and the overall average trends from ordered probit regressions of well-being on country and year fixed effects  
 Source: Stevenson and Wolfers (2008)

darity, civic engagement and – more generally – to pro-social behaviors. The degree of materialism is measured in individuals and related to the quality of their relationships with others. A general finding of these studies is that the more people care about money, image and status, the poorer is the quality of their social and affective relationships (see Kasser et al., 1995, Cohen and Cohen, 1996, Belk, 1985, McHoskey, 1999, Kasser and Sheldon, 2000, Sheldon et al., 2000, Kasser, 2002). In other words, more materialistic individuals are expected to have a reduced capacity to build satisfying relationships, i.e. the capacity to build social capital. As a matter of fact, the diverging trends of social capital exhibited by U.S. and Europe seem to be matched by diverging trend concerning materialistic values: Bartolini and Sarracino (2012), using internationally comparable data over the last 25 years, find that in the US materialism increased while in Europe decreased.

The negative association between the trends of consumption on one hand, and those of well-being, social capital and materialism on the other, may call for some explanations that are not mutually exclusive, but may eventually reinforce each other.

### **3 POSSIBLE EXPLANATIONS OF THE U.S. HYPERCONSUMERISM**

#### **3.1 “Hedonic treadmill” and “positional arms race”**

The “hedonic treadmill” theory (see Brickman and Campbell, 1971, Diener et al., 2006), according to which people quickly adapt their aspiration levels to the new consumption standards that they have reached, might be invoked to explain why in the last decades there was no positive correlation between average well-being and consumption in the United States. The adaptation hypothesis is a consolidated theory that has accumulated compelling evidence, but it does not suggest any cross-country difference in the trends of well-being (Inglehart, 2010). If the tendency to adapt one’s self to changing circumstances is a distinctive trait of human nature, then the trends of well-being in different countries whose GDP has grown over time cannot exhibit opposite signs, as it is the case for Europe and the U.S.

Aspiration levels may also change depending on the particular group of people whose consumption standards are taken by an individual as his/her frame of reference for making comparisons. These comparisons involve the so called “positional goods”, which are goods particularly salient because of their visibility or symbolic meaning (e.g., cars or houses) for comparing one’s consumption with what other people consume (Frank, 2007). In this sense, the rush to buy SUVs and large houses, which typifies the U.S. consumption boom of the 2000s, can be considered an example of a “positional arms race”, “in which everyone stands up to get a better view, yet no one sees any better than before.” (Frank, 2007, p. 12). Increased income inequality exacerbated this race: “Additional spending by the rich shifts the frame of reference that defines what the near rich consider necessary or desirable, so they too spend more. In turn, this shifts the frame of reference for those just below the near rich, and so on, all the way down the income ladder” (Frank, 2009, p. 13). This mechanism is consistent with both the growing skewness that has characterized the American income distribution since the 1970s and the huge debt accumulated by the U.S. households to finance consumption over the period preceding the crisis, since it is hard for the near rich to keep up with the rich without going into debt. Furthermore, it may help explaining why in those years the systematic consumption-bias inherent in the American society intensified (Wright and Rogers, 2011, chap. 7). Finally, it is also consistent with the U.S. trend of market work, since empirical studies show that social comparisons foster labor supply (Bowles and Park, 2005, Neumark and Postlewaite, 1998,

Clark and Oswald, 1998). However, the metaphor of a “positional arms race” does not provide any particular insight about the origin of those peculiar preferences and cultural values that give prominence to social envy and determine what goods are positional and what are not.

### **3.2 Preferences and cognitive limits**

The analytical approach of an economist typically takes agents’ preferences as given. It should be apparent that this does not make sense in this context, where identifying the forces that shape, influence and change people’s convictions and preferences, particularly those affecting the allocation of time and efforts between the pursuit of material goods and the cultivation of human relationships, is an essential part of any attempt of better understanding the American consumption-bias. This is especially true because social and political psychologists – together with cognitive scientists – have accumulated an overwhelming evidence undermining the assumption “that people have preferences that predate framing, default rules, and social interactions” (Sunstein, 2006, p. xvi). Especially if we go beyond the basic needs for food, drink, shelter and rest, it is widely accepted that preferences and desires are cultural traits depending on the narratives used by the individuals to categorize the world, to give sense to both their inner and outer experience, and to construct their identity (see, e.g., Akerlof and Kranton, 2000, 2005, Hill, 2008). Consistently with this approach, it is legitimate to challenge the idea that consumers are sovereign in their choices, in the sense that their choices reflect (and reveal) their “true” preferences: “If people display bounded rationality when it comes to maximizing utility, then their choices do not necessarily reflect their “true” preferences, and exclusive reliance on choices to infer what people desire loses some of its appeal” (Kahneman and Krueger, 2006, p. 3). In other words, psychologists’ evidence is at odds with the “hedonic fallacy” consisting in “the belief that people know precisely what they are feeling, can explain why they are feeling that way, and, on the basis of this knowledge, can, within their means, maximize their utilities” (Lane, 2000, p. 284). The existence of these pervasive cognitive limits is consistent with the hypothesis that incentive structures and powerful industries (advertising, media culture, etc.) present in contemporary market economies have successfully pushed people into substituting short-term materialistic wants, which can be satisfied on the marketplace, for long-term happiness, which can be pursued by investing time and effort to develop deep interpersonal relations (see Lane, 2000). As a consequence of this systematic distortion of individual “true”

preferences, people's choices do not manifest their inner needs and deep desires whose satisfaction can be conducive to happiness, but rather "compensatory inauthentic" wants whose gratification leave individuals intimately unsatisfied, beside requiring stressful efforts and sacrifices in other life dimensions (Lane, 2000). A by-product of this systematic distortion is the weakening of those psychological mechanisms underlying people's capacity to defer gratification and avoid certain compulsive behaviors: decline in personal saving, diffusion of obesity, compulsive buying or workaholism may be linked to this weakening.

The powerful forces that are at work to shape people's preferences and behaviors nudging them towards consumption are present in all contemporary market economies but not to the same extent. Per-capita expenditures on advertising has been four times greater in the U.S. than in continental Europe (Mulgan, 2012); and in addition, as we have seen in the previous section, institutions and public policies affecting people's incentives, constraints, and attitudes relative to work and consumption differ across countries. In a long-term perspective, these differences reflect different societal preferences and shared values, which reinforce the heterogeneity across countries due to the history-dependence of national political cultures and the inertia of the rules of the game embodied in the functioning of the various institutional systems. Along these lines, one can probably explain why public policies are less redistributive in the U.S. than in continental Europe (see, e.g. Alesina et al., 2001), or social norms are more inclined to favor longer per-capita hours of market work in the U.S. than in continental Europe (see, e.g. Bonatti, 2008). Indeed, people's worldviews and mass ideologies interact with dominant constellations of interests in determining those policies. With regard to this, it is worth noting that cognitive limits condition not only the formation and evolution of individual preferences underlying private choices, but also the shaping of those collective preferences that inspire public policies. Mass opinions and shared convictions are often closely intertwined with biased beliefs and factually distorted representations of the social world. And this can have a big impact on redistributive policies or on policies that affect the degree of "marketization" of a society. It is well known, for instance, that the "belief in a just world" is much more diffuse in the United States than in continental Europe, although there is no factual justification for such a difference (see Bénabou and Tirole, 2006), or that the conviction that in the United States the poor have more chances than in "socialist" Europe to move up the economic ladder is widespread amongst Americans in spite of its weak empirical basis (and even in spite of

the easily accessible evidence showing that it is clearly false in comparison to many European countries!).

### **3.3 Externalities and the NEG (Negative Endogenous Growth) paradigm**

If the notion that markets tend generally to operate efficiently and fairly is widely accepted, the consensus for collective actions aimed at correcting the distributive outcomes or the externalities generated by market activities is likely to be weak. The difficulty of building a consensus about policies addressing externalities is augmented by the fact that, in complex social environments, the relationships between events and phenomena are often indirect and systemic, and it is rarely possible to identify univocal causal relationships between them. Therefore, people's cognitive limitations make it sometimes quite hard to disentangle the multiple and intricate links connecting certain activities, conducts or propensities that markets promote or intensify to social phenomena that seemingly have no or little relations to them. It is not straightforward, for instance, to look at the diffusion of opportunistic or even fraudulent behaviors as a by-product ("negative externality") of the progressive "marketization" of social relationships, with the associated predominance of acquisitive values and instrumental attitudes. Or, it is not obvious for many Americans that there is some connection between a mass culture exalting personal success and the temptation to pursue it by illegal means (see, e.g. Lipset, 1996).

The NEG (Negative Endogenous Growth) approach recognizes not only the relevance for people's well-being of the negative externalities that the growth process – and the related expansion of the market sphere – brings about, but also the important role that these negative externalities may play in feeding GDP growth (Bartolini and Bonatti, 2002, 2003, 2008). In fact, the erosion of environmental and social assets caused by the increase in market activity limits the possibility to benefit from them, thus inducing consumers and producers to search for substitutes in the marketplace. More in general, growth is conceived as a substitution process whereby market goods and services progressively replace declining non-market sources of well-being and compensate for the negative effects of the increased marketization of society. This process is self-feeding and can be described as a reinforcing loop: the externalities generated by the expansion of market activities stimulates households and producers to compensate them by buying more goods and services, thus feeding this expansion. Consistently with this approach, GDP growth may "go too far", in the sense that its acceleration may bring

more detrimental effects on people's welfare than benefits.

Rising defensive expenditures for protection from environmental damages and deterioration can be straightforwardly interpreted in the logic of the paradigm outlined above<sup>6</sup>. The same holds for the explosive increase in the U.S. expenditures in formal activities of social control and dispute resolution that occurred in the last decades of the 20th century, which according to Putnam (2000) is a consequence of the steady decline in social trust over that period.<sup>7</sup> Indeed, this increase is consistent with the hypothesis that the erosion of social capital (trust, work ethics, honesty) stimulates the rapid expansion of entire sectors of the economy, which are the sectors providing those goods and services that individuals and organizations use to protect themselves against rising opportunistic and defiant behavior by others. The growth of these sectors is surely related to the secular rise in the "transaction cost sector" documented by Wallis and North (1986) for the U.S. economy<sup>8</sup>. Finally, this growth - which is paralleled by the decline in peer monitoring and informal sanctioning - can be considered a symptom of the increasingly explicit nature of norm enforcement that proceeds with modernization (see Jayadev and Bowles, 2006)<sup>9</sup>. The amazing figure of 2 million people that in the 2000s are in U.S. prisons says more than anything else on the subject.

One could argue that also some of the rapid increase in U.S. health expenditures that has occurred in the last decades is a result of the negative externalities brought about by economic growth.

This hypothesis receives some support by the evidence linking the higher levels of anxiety reported by Americans in the last decades of the 20th century to the symptoms of many diseases (asthma, ulcers, coronary heart disease, irritable bowel syndrome, inflammatory bowel disease) (see Twenge, 2000). Stress may probably increase the susceptibility to disease by inducing people to have less healthy life-styles and, above all, by weakening the immune system

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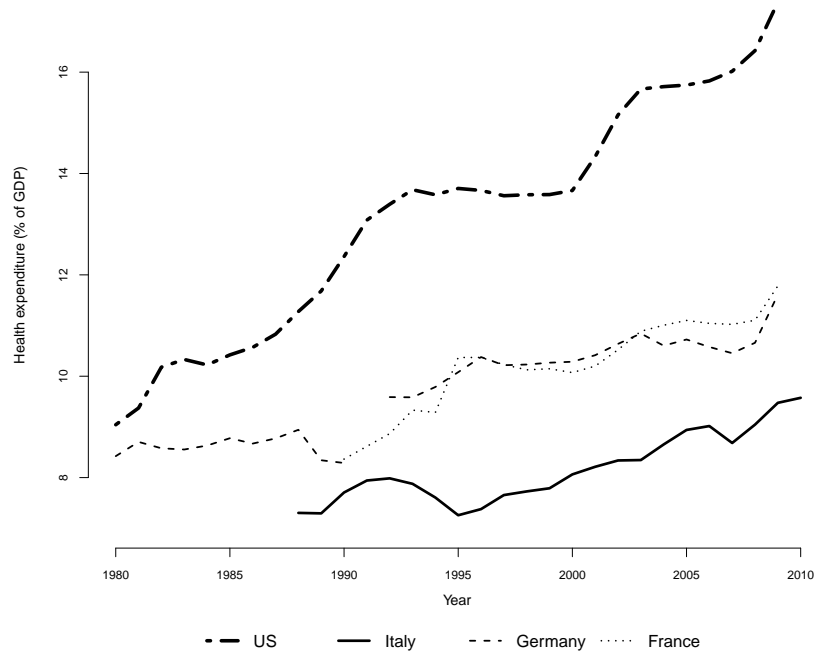
<sup>6</sup>On the concept of defensive expenditure, see Nordhaus and Tobin (1973).

<sup>7</sup>Putnam (2000) emphasizes that during the 1980s (namely, in a period in which the external threat represented by international terrorism was not yet perceived as relevant) spending on security rose rapidly as a share of U.S. GDP. Moreover, he observes that by 1995 the United States had 40% more police and guards and 150% more lawyers and judges than would have projected in 1970, even given the growth of population and the economy (Putnam, 2000, p. 146).

<sup>8</sup>Wallis and North (1986) estimated that the transaction cost sector (private plus public) amounted to 26.1% of U.S. GDP in 1870 and to 54% in 1970.

<sup>9</sup>Jayadev and Bowles (2006) document that supervisor and guards (police, corrections officials and security personnel) were 17,5% of the U.S. labor force in 2002, while the corresponding figure was 10.8% in 1966.

Figure 15: Trends of Total Health Expenditures Across Countries\*



\*Health expenditures include both public and private ones. Values are expressed as percentages of GDP  
 Source: OECD (2011)

(see Shields, 2004, Wilkinson and Pickett, 2009). Moreover, stress has been often associated to the time-crunch experienced by a rising number of Americans (see Hamermesh and Lee, 2007), while – in its turn – time-crunch seems to be related more to the hours of paid work than to the hours of domestic work (see Beaujot and Andersen, 2007). Notice that – among other reasons – this may be due to the fact that “Unpaid domestic work is especially important for the QoL [Quality of Life] of families with young children”, since “most of the time spent caring for children is usually delivered while performing other tasks” (Stiglitz et al., 2009, p. 175).

The evidence indicating that the hours of paid work are perceived to be more stressful than the hours of domestic work provides some argument in favor of the thesis that the time spent on paid work has worse effects on well-being than the time spent working at home. This thesis reinforces the conclusion that the diverging evolution in the allocation of households’ time between U.S. and Europe may have contributed to determine the difference in their performances in matter of happiness. The NEG approach helps explaining why the U.S. – differently than Europe – devoted the productivity advancements occurred in the last 40 years entirely to increase market consumption, rather than to reduce the hours of paid work, by pointing at the



greater pressure that an environment poorer in terms of universal entitlements, collective infrastructures and social assets exerted on the U.S. households. According to this view, lower levels of market work in Europe should be related to the prevalence of a socio-economic equilibrium richer in terms of entitlements, collective goods and social assets. Therefore, differences in labor income taxes, labor-market institutions and preferences for leisure between the U.S. and Europe should be considered as parts of a more encompassing difference between two distinct socio-economic models.

Time and energies devoted to work are diverted away from social connections: people devoting more time to their job dedicate relatively fewer hours to personal relations and social activities. This is consistent with the evidence provided by Bartolini and Bilancini (2011), who use U.S. data from the period 1972-2004 to show that participation in social activities substantially decreases the hours worked.<sup>10</sup>

In sum, it appears that more hours of market work end up impoverishing those activities that are essential for the formation of social capital. This impoverishment tends to be compensated by greater interest in money and commodities, thus inducing people to work harder in order to increase their earnings and buy more goods. Hence, one may argue that social capital and work hours may be linked by a self-reinforcing mechanism, whereby the deterioration of social capital boosts market work, which in its turn feeds back into the decline of social capital.

U.S. households not only worked more hours in order to pay for expensive defensive expenditures and additional market products that may substitute for other sources of well-being, but also spent an increasing portion of their leisure time in activities that are very intense (and expensive) in terms of use of market goods and services. Related to this commodification of leisure, there was the process – documented by Putnam (2000) – of “privatizing” or “individualizing” of the leisure time (mainly due to the TV and more in general to the diffusion of home-entertainment technologies). This process can be considered both an effect and a cause of a social environment increasingly poor for what concerns the possibility of enjoying deep and gratifying human relations.

According to Lane (2000), the unsatisfied famine of warm interpersonal relations and in-

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<sup>10</sup>This evidence indicates also that individual participation in local networks generates positive spillovers: the higher is the individual engagement in these networks, the higher is the probability that a single individual participates.

clusive memberships, that characterized the booming America of the late 1990s, creates an urgent drive for commodities, as substitutes for deep relational experiences and compensation for aloneness. Obviously, the result of such a collective drive is more market activities and an even poorer human and social environment, which further exacerbates people's appetite for consumption. This cycle can be naturally interpreted in the light of the NEG paradigm as a typical reinforcing loop, with individuals reacting to the impoverished human landscape brought about by years of rapid economic growth by a compensatory hyper-consumerism. In the period preceding the crisis, this cycle was pushed too far by the unprecedented easiness with which American households could go into debt.

The NEG approach suggests that the decline in happiness and social capital, and the increase in materialism, work hours and consumerism can be the intertwined aspects of the same growth process. Unsurprisingly, this process may even lead to a decrease in well-being. Admitting that the U.S. decline in happiness that has occurred in the last 30 years is linked to the gradual erosion of interpersonal trust, social connectedness and other variables related to social capital (see Bartolini et al., 2011), one could conclude that the well-being gains from economic growth have been more than compensated by the well-being costs that it has brought about.

## **4 POSSIBLE WAYS OUT**

### **4.1 Policy responses to the crisis**

We have seen that at the root of the current crisis there was the bulimia of the U.S. consumers, which came out of control when the households' access to credit was made easier and cheaper. As the real estate bubble burst and the subsequent households' insolvencies turned into a major financial crisis, U.S. policy makers intervened by bailing out banks and a few non-financial corporations, increasing households' disposable income through tax rebates and subsidies, and spending on public works. The scope was to temporarily replace the missing consumers' demand with increased government expenditures, at the same time curing the financial system so as to prevent further bankruptcies and a more severe credit crunch, and giving relief to the heavily indebted low-middle class, in the hope that in this way the spending capacity of the U.S. households would have been restored soon, thus triggering a new cycle of hiring and investment by firms. In the process, large chunks of private debt have been transformed into public debt and considerable quantity of dubious assets originated in the private sector have been absorbed by public entities.

### **4.2 Mainstream policy alternatives**

The results of the massive intervention outlined above are controversial, since on the one hand one could argue that it was crucial for preventing the melting down of the financial system and a dramatic fall in the level of economic activity, while on the other hand it does not appear to have been sufficient to move the U.S. economy definitely away from a disappointing low-growth scenario and toward a self-sustained high-growth path. In particular, policy makers and observers are currently concerned by the persistent inability of the economy to create enough jobs for reducing substantially the stubbornly high unemployment rate. In this situation, one may schematically identify two alternative standpoints regarding the policy agenda deemed desirable for allowing the U.S. economy to grow at a sustainable rate consistent with a non-transient re-absorption of the currently high unemployment. The first viewpoint is typical of those "liberal" economists who claim that the stimulus programs until now undertaken by the Obama administration were too timid, and that another big fiscal expansion would be necessary to get back to a satisfactory growth trajectory. These economists, indeed, claim that

the obsession of curing the currently high federal deficit with immediate expenditure cuts is self-defeating, since the resulting impact would magnify and prolong the depressing effects on the economy of the currently low propensity to spend on the part of households and firms, thus making impossible to reduce in the long run both the unemployment rate and the federal debt as a ratio of the GDP. Opposing this vision, it is the standpoint of those believing that fiscal-stimulus packages choke off private investment by creating the expectation of inevitable future tax increases for dealing with the growing public debt. As an example of this, these “free market” economists mention the anemic recovery that is under way in the United States, with firms that prefer to hold large chunks of liquidity created during the recent repeated episodes of quantitative easing rather than using them to finance new investment and to create jobs. Consequently, they advocate drastic cuts to expensive federal programs that could allow reducing both taxes and public debt. In this way, it is possible to reawake those “animal spirits” without which, they maintain, the U.S. economy would be locked in the same low-growth trap characterized by high taxes and low incentives to work and invest that is typical of continental Europe.

What the two visions outlined above have in common, it is the conviction that after some minor repairs and with appropriate policies the U.S. economy can resume its previous growth model, while the main divide between the two is on the policies suited to achieve this objective. However, the point that we want to emphasize here is that a return to that pattern of growth is not very realistic in the long run, because it is hardly sustainable for structural reasons that are independent of the long-term environmental concerns that are often mentioned.

The very loose external constraint faced by the U.S. economy has permitted it for decades to have a volume of domestic demand well in excess of the resources generated in the country. This has made possible for those sectors that are not exposed to foreign competition - mainly services - to reach a relative size that has no comparison in the other large economies. These sectors are exactly those that have created in the years the millions of jobs that give employment to most low-skilled and marginal workers. The bulimia of the U.S. consumers, besides feeding the demand for exports, has inflated these sectors representing a major source of jobs.

As is argued in section 2, the U.S. pattern of growth has been closely intertwined with its endemic current account deficit and with the willingness by the rest of the world to go on financing these deficits. Considering the recent increasing concerns for the sustainability of

both private and sovereign debt, it is not realistic that the United States could return to their pre-crisis levels of external deficits. This conclusion is reinforced by the fact that the priorities and the attitudes of those foreign official entities, which with their accumulation of U.S. assets were so important to enable the United States in the 2000s to finance their external deficit at low cost, are going to change in the predictable future. These considerations have also motivated those invoking a rebalancing of the U.S. economy that will make it less dependent on domestic demand and more oriented toward exports. However, even admitting that exchange-rate and aggregate-demand policies in the rest of the world will be compatible with this adjustment, one may argue that such rebalancing is likely to bring about a relative shrinking of the labor-intensive non-tradable sectors, with a resulting net loss of jobs and emergence of structural unemployment.

### **4.3 A possible third option**

It is apparent that the future expansion path of the U.S. domestic demand is very likely to remain permanently below the trajectory that one could have anticipated by extrapolating the trend that it exhibited in the decade preceding the crisis. It is also hard to believe that some shift moving productive inputs away from non-tradables and toward tradables will be sufficient to avoid structural unemployment. Therefore, if the two mainstream policy alternatives discussed above do not seem to provide any guarantee that at least in the medium- and long-run the U.S. economy will resume a sustainable and socially acceptable growth path, it can make sense to take seriously into consideration a more radical policy option. One can indeed think of policies that, instead of reinvigorating mass consumerism, are aimed at stimulating a gradual shift in lifestyles away from market activities and toward the enjoyment of more free time, richer human relations and better-quality social and environmental assets. It is straightforward that such a shift would require a change in mass culture, values and preferences which can be only partially influenced by public policies, but the latter may play a role in creating the conditions for this shift. As is argued in section 3, policies that allow the households to have access at low cost to high-quality social and environmental assets will reduce the need for them to substitute these assets with costly private goods and services. In particular, entitling all citizens to have access at low cost to good-quality education, health and efficient public transportation services (where the enterprises providing them may not be owned or managed

by the government) will put less pressure on household to work more in the marketplace in order to buy necessary but costly services. Obviously, this policy shift will require higher taxes (above all on consumer goods and services) and government expenditures in infrastructures and public goods, thus affecting the relative convenience of enjoying leisure time rather than consuming, and favoring the emergence of habits and social norms that will make the United States more similar to some central or northern European countries. As a result, also the trend of rising wealth and income inequalities that has characterized the United States in the last decades will be interrupted and reversed.

The process of gradual reduction of the “consumption bias” inherent in the American society will have a negative impact on domestic demand, thus making easier for the U.S. economy to shrink its endemic external imbalances. Moreover, given the current structural characteristics of the U.S. economy, a simple rebalancing of the U.S. growth model away from consumption without a parallel shift in collective priorities and individual preferences would imply high costs in terms of unemployment and frustration, in particular for the low middle class that would be more directly affected by them. Therefore, the gradual reduction of the “consumption bias” should be carefully coordinated by policy makers with the parallel decline in the amount of time that the U.S. households wish to dedicate to paid work, so as to reach a new full-employment equilibrium path characterized by both less consumption and less market work. It is worth to notice that the emergence of such a socio-economic equilibrium does not mean stagnation: economic dynamism and quality improvements will be driven by innovations and productivity advances, with the possibility that the latter will be partially translated into further reductions of per-capita working time and not entirely devoted to increased production of goods and services.

## **5 CONCLUSION**

A serious obstacle to the activation of a policy agenda aimed at curing the systematic consumption bias and related workaholism peculiar to the American society appears to be ideology. Even if in recent decades the U.S. has not done well relatively to other advanced countries in terms of subjective well-being and other indicators of life quality, nevertheless mainstream politicians and intellectual elites are stubbornly committed to a static defense of some of the most questionable aspects of the American socio-economic model, which are probably per-

ceived as constituent parts of the “American exceptionalism”. It will be interesting to see if the difficulties that the U.S. hyper-consumerist pattern of growth is facing will seriously undermine this diffuse faith in the overall superiority of the “American way of life”. Without a shift in mass culture and societal preferences, no change in growth paradigm will be possible. How realistic is the possibility that this shift will occur in the predictable future is hard to say; what is sure is that there are structural features and powerful forces that tend to lock the system into its current socio-economic trajectory.

## **A Trends of US Social Capital from 1975 to 2004**

Table 1 summarizes the trends of several proxies of social capital observed between 1975 and 2004 in U.S. (Bartolini et al., 2011). Social capital is proxied by several indicators observing the marital status of the respondent, its trust in others, its perception of other people as fair and helpful, the frequency of interactions with relatives, neighbors, friends and people at bar, involvement in groups and associations, and the confidence in institutions. The U.S. GSS asks whether the respondent is member of a broad list of groups and associations, comprising religious, sport, cultural, political and environmental issues. To reduce the number of dimensions, all these variables have been grouped in to three categories: putnamian, olsonian and other groups. This classification mirrors the different interpretation that Putnam and Olson give of group membership. In the first case, participation in networks of association is seen as a way to enhance general trust and social ties and, ultimately, leading to economic and governmental efficiency. In this set are included groups such as: social service, church organizations, sport associations, art and literature groups, fraternal and youth associations, as well as human and animal rights. In the second case, groups are mainly seen as lobbies to protect the interests of specific groups on the back of the society as a whole. In this set are included groups such as: labor unions and professional organizations. Finally, some groups are left unclassified and included with the label “other” groups. These are groups for which the aforementioned distinction is unclear and concerns associations such as: veterans associations and political parties. For each of the three categories, the table reports the trends of both whether the respondent is member or not and, eventually, the number of groups one is member of.

For each proxy of social capital, trends are estimated using ordered probit (OLS) models over time and robust standard errors. Probit or OLS models are used depending on the nature of the dependent variable, i.e., ordinal or cardinal. The coefficient of the time regressor is used to summarize the direction and the significance of the trend of the dependent variable over the considered period. It is reported in columns 2 and 4 of table 1. Negative (positive) coefficients stand for negative (positive) trends. The asterisks report the significance of the trend: \* means significant at 10%, \*\* means significant at 5%, \*\*\* means significant at 1%.



Table 1: Trends of US Social Capital from 1975 to 2004

Probit (# is OLS)	Time Coeff.	Probit (# is OLS)	Time Coeff.
Married	-0.030***	Other Groups	-0.004**
Separated	0.038***	# other Groups	-0.001**
Divorced	0.003	Confident in banks	-0.024***
General trust	-0.015***	Confident in companies	-0.006***
People unfair	0.010***	Confident in org. religion	-0.023***
People helpful	-0.006***	Confident in education	-0.024***
Monthly with relatives	-0.001	Confident in executive	-0.007***
Monthly with neighbors	-0.015***	Confident in universities	-0.010***
Monthly with friends	0.006***	Confident in press	-0.045***
Monthly at bar	-0.009***	Confident in medicine	-0.020***
1-2 Putnam's Groups	-0.010***	Confident in television	-0.030***
3+ Putnam's Groups	0.002	Confident in sup. Court	0.0002
# Putnam's Groups	-0.003**	Confident in science	-0.003***
1 Olson's Group	-0.008***	Confident in congress	-0.020***
2+ Olson's Groups	0.004	Confident in military forces	0.016***
# Olson's Groups	-0.001**		

Source: Bartolini et al. (2011)

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